

Message Text

CONFIDENTIAL

PAGE 01 MOSCOW 15970 01 OF 02 211904Z

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USMISSION EC BRUSSELS

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AMEMBASSY WARSAW

AMEMBASSY TOKYO

C O N F I D E N T I A L SECTION 1 OF 2 MOSCOW 15970

E.O. 11652: GDS

TAGS: EGEN ETRD ENRG EFIN UR

SUBJECT: INFLATION AND THE SOVIET UNION

1. SUMMARY: REVIEWING POSSIBILITIES OF IMPORTED AND
DOMESTIC INFLATION IN THE USSR IN THE FALL OF 1974, EMBASSY
CONFIDENTIAL

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PAGE 02 MOSCOW 15970 01 OF 02 211904Z

ASSESSMENT IS THAT RISING WAVE OF INFLATION IN DEVELOPED

CAPITALIST COUNTRIES HAS HAD VIRTUALLY NO IMPACT ON PRICES IN SOVIET UNION AND THAT--WITH SOME EXCEPTIONS--THE SOVIET CONSUMER HAS NOT BEEN BURDENED WITH SERIOUS INFLATION IN HIS EVERYDAY LIFE. END SUMMARY

I. FOREIGN TRADE - THE IMPACT OF INFLATION FROM THE CAPITALIST WORLD

2. IT IS EMBASSY'S OVERALL ASSESSMENT THAT--FOR VARIOUS REASONS--SOVIET ECONOMY HAS NOT YET SUFFERED SERIOUS DIFFICULTIES FROM THE SHARPLY RISING WAVE OF INFLATION WHICH HAS ROCKED THE DEVELOPED COUNTRIES OF THE CAPITALIST WORLD OVER THE PAST YEAR. WHILE IN PRIVATE CONVERSATIONS INDIVIDUAL FOREIGN TRADE OFFICIALS COMPLAIN ABOUT BRINGING IN INFLATION AS REPRESENTED BY INCREASED PRICES OF WESTERN INDUSTRIAL GOODS, THE OFFICIAL SOVIET RESPONSE TO THE SUGGESTION THAT THE USSR MUST BE IMPORTING INFLATION FROM THE WEST IS SHORT AND GLIB: "OF COURSE NOT--WHILE WE MUST PAY HIGHER PRICES FOR WESTERN GOODS, WE ALSO RECEIVE MORE FOR WHAT WE SELL IN WESTERN COUNTRIES." ACTUAL SITUATION IS MUCH MORE COMPLEX, INVOLVING SPECIAL FACTORS WHICH EVOLVE BOTH FROM MOSCOW'S UNIQUE, COMMAND-CONTROL, ECONOMIC-POLITICAL SYSTEM AND USSR'S FORTUNATE POSITION OF NEAR SELF-SUFFICIENCY IN NATURAL RESOURCES. THEY INCLUDE FOLLOWING:

A) IN THE SOVIET ECONOMY FOREIGN TRADE PRICES ARE ALMOST TOTALLY ISOLATED AND SEPARATED FROM INTERNAL WHOLESALE PRICES. IF, IN MID-1974, A SOVIET FOREIGN TRADE ORGANIZATION PAYS DOLS 10,000 FOR AN ITEM OF WESTERN EQUIPMENT WHICH COST ONLY DOLS 7000 SIX MONTHS EARLIER, THE INTERNAL PRICE PAID BY A FACTORY IN SIBERIA USING THE EQUIPMENT REMAINS THE SAME AS IT WAS SIX MONTHS OR A YEAR OR THREE YEARS EARLIER. WESTERN PRICE RISES ARE THUS FULLY ABSORBED BY THE SOVIET GOVERNMENT. ALTHOUGH THE COSTS OF THIS ABSORPTION MAY BE GROWING LARGER AND MORE ONEROUS, THE PROBLEM HAS NOT YET AND MAY NEVER BECOME SERIOUS, FOR REASONS WHICH FOLLOW BELOW.

B) TOTAL SOVIET FOREIGN TRADE FOR 1973 REACHED SOME
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PAGE 03 MOSCOW 15970 01 OF 02 211904Z

31.1 BILLION RUBLES, OF WHICH ABOUT 4.6 BILLION REPRESENTS IMPORTS FROM DEVELOPED CAPITALIST COUNTRIES AS COMPARED WITH 9.2 BILLION IN IMPORTS FROM SOCIALIST (CHIEFLY EAST EUROPEAN) SOURCES. THUS, GOODS WHOSE PRICES WERE DIRECTLY INFLUENCED BY STRONGLY INFLATIONARY TRENDS CONSTITUTE A MINOR IF VITALLY IMPORTANT ELEMENT IN TOTAL SOVIET FOREIGN TRADE.

C) SOVIET CONTRACTS FOR WESTERN MACHINERY AND EQUIPMENT WHICH--WITH EXCEPTION OF YEARS WHEN USSR MUST IMPORT GRAIN--CONSTITUTE THE BULK OF SOVIET IMPORTS FROM THE DEVELOPED WEST, ARE CAREFULLY STRUCTURED SO AS TO LIMIT THE IMPACT OF WESTERN PRICE RISES. BEST AND MOST CLASSIC SOVIET DEFENSE AGAINST ESCALATING WESTERN PRICES IS USED IN "MACRO-DEALS" FOR PURCHASES OF PLANTS, COMPLETE INDUSTRIAL COMPLEXES FROM WESTERN COUNTRIES. HERE REPAYMENT IS MADE OVER A NUMBER OF YEARS NOT IN FOREIGN EXCHANGE BUT IN PRODUCTS, AND USUALLY THE OUTPUT FROM THE PROJECTS INVOLVED--NATURAL GAS, CHEMICAL FERTILIZER, ASBESTOS, COAL, STEEL. CONSEQUENTLY, HIGHER PRICE TAGS ARE OFFSET BY NATURAL RESOURCES, MOST OF THEM STILL IN THE GROUND, AND WHOSE PRICES ARE STEADILY RISING IN THE WORLD ECONOMY. THERE ARE OTHER OFFSETS--LONG-TERM CREDITS, FREQUENTLY AT CHEAP INTEREST RATES, WHICH CAN BE REPAYED AT A COST WHICH IS LESS THAN THE YEARLY INFLATIONARY DEPRECIATION IN THE VALUE OF WESTERN CURRENCIES; MARKED RELUCTANCE AND USUALLY OUTRIGHT REFUSAL TO AGREE TO COST ESCALATION CLAUSES IN SMALL SUPPLIER CONTRACTS AND STRONG EFFORTS TO AVOID THEM IN LARGER DEALS.

D) THE SUDDEN, SHARP RISE IN WESTERN PRICES WHICH BEGAN IN THE WINTER OF 1973-74 HAS NOT HAD ITS FULL IMPACT ON SOVIET IMPORTS FROM WESTERN FIRMS. A SUBSTANTIAL PORTION OF CAPITAL GOODS IMPORTS THIS YEAR IS BEING DELIVERED UNDER CONTRACTS NEGOTIATED BEFORE THIS YEAR'S INFLATIONARY UPSWING.

E) FINALLY, THERE IS OFTEN OVERLOOKED FACT THAT THE SOVIET UNION IS NO LONGER A FINANCIALLY POOR COUNTRY. THIS CHANGE IN STATUS HAS COINCIDED WITH THE SUDDEN APPEARANCE OF THE WORLD ENERGY CRISIS AND THE ACCOMPANYING ONSET OF WESTERN INFLATION. SOVIET GOLD RESERVES ALONE HAVE APPRECIATED AS MUCH AS FIVE TIMES IN VALUE OVER PAST FEW YEARS. SIMILAR
CONFIDENTIAL

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PAGE 04 MOSCOW 15970 01 OF 02 211904Z

APPRECIATION HAS OCCURED FOR DIAMONDS, PLATINUM, OTHER RARE METALS. THE AS-YET LIMITED AMOUNTS OF OIL AND NATURAL GAS WHICH THE USSR HAS BEEN ABLE TO SELL ON WORLD MARKETS ARE EARNING RECORD AMOUNTS OF HARD CURRENCY--AND SOVIET INTERNAL RESERVES OF SOME OF THESE PRODUCTS AND OTHER INDUSTRIAL RAW MATERIALS ARE SO SUBSTANTIAL THAT, IN SOME INSTANCES, THEY ARE AMONG THE LARGEST IN THE WORLD. THIS NEW WEALTH GIVES USSR ITS MOST FAVORABLE BALANCE OF PAYMENTS POSITION EVER. CONSEQUENTLY ABSORPTION OF INCREASED WESTERN EQUIPMENT PRICES WHILE MAINTAINING A TIGHT, STABLE INTERNAL PRICE SYSTEM IS FULLY FEASIBLE, AN EXPENSE WHICH MOSCOW CAN FULLY COVER IN RETURN FOR THE DOMESTIC POLITICAL DIVIDENDS WHICH SUCH A PRICE SYSTEM PROVIDES.

CONFIDENTIAL

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PAGE 01 MOSCOW 15970 02 OF 02 211923Z

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C O N F I D E N T I A L SECTION 2 OF 2 MOSCOW 15970

3. IT SHOULD BE NOTED THAT AGRICULTURAL IMPORTS CONSTITUTE AREA WHERE SOVIETS LEAST ABLE TO HEDGE AGAINST COSTS OF ABSORBING RISING WESTERN PRICES. HERE THEY MUST OCCASIONALLY PAY DEARLY FOR THEIR AGRICULTURAL INEFFICIENCY IN TERMS OF MASSIVE GRAIN AND AGRICULTURAL EQUIPMENT PURCHASES--WHILE AT SAME TIME MAINTAINING A LOW DOMESTIC PRICE FOR BREAD,
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PAGE 02 MOSCOW 15970 02 OF 02 211923Z

MEAT AND OTHER STAPLES--A SENSITIVE EMOTIONALLY-CHARGED AREA WHICH MUST BE KEPT STABLE FOR POLITICAL REASONS. THUS, HERE AGAIN, IMPORTED INFLATION IS DEFTLY WIPED OUT BY GOVERNMENT ACTION.

II. THE INTERNAL ECONOMY - THE POSSIBILITY OF INFLATION FROM WITHIN

4. CONTRARY TO RECENT ARTICLES IN THE WESTERN PRESS, THE EMBASSY FINDS SCANT EVIDENCE OF SERIOUS INFLATION IN THE SOVIET RETAIL PRICE SYSTEM--THE VAST, INTRICATE STRUCTURE WHICH FIXES PRICES FOR EVERY ITEM THE SOVIET CONSUMER CAN BUY--FROM BREAD TO AUTOMOBILES. THERE HAVE BEEN SOME EXCEPTIONS--NOTED BELOW--BUT OVERALL THE SOVIET PRICE SYSTEM REMAINS A STABLE MONOLITH, IN SMUG CONTRAST TO THE "FEVERISH PRICE FLUCTUATIONS IN WESTERN CAPITALIST COUNTRIES" WHICH ARE LAMPOONED REGULARLY IN THE SOVIET PRESS.

5. LARGELY FOR POLITICAL REASONS, SOVIET POLICY PROHIBITS RETAIL PRICE INCREASES ON ALMOST ALL CONSUMER GOODS SOLD IN STATE STORES. RECENT EXCEPTIONS HAVE INCLUDED LUXURY ITEMS SUCH AS CAVIAR, SMOKED FISH, AND JERWERLYRY CRAFTED FROM PRECIOUS METALS. ON ALMOST ALL OTHER GOODS AVAILABLE TO THE PUBLIC, OFFICIAL PRICES HAVE NOT RISEN FOR MANY YEARS. IN DECEMBER 1973, THERE WERE WIDESPREAD RUMORS OF IMPENDING PRICE RISES FOR VARIOUS GOODS, PARTICULARLY AUTOMOBILES AND GASOLINE, BUT THESE INCREASES WERE ANNULLED AT LAST MINUTE FOR UNKONWN REASONS. SOVIET CONTACTS LATER TOLD EMBASSY OFFICERS THAT LARGE-SCALE HOARDING OF GASOLINE COUPONS HAD TAKEN PLACE IN ANTICIPATION OF THESE INCREASES. IN GENERAL, SOVIET PRICING POLICY FOR CONSUMER GOODS IS DIRECTED AT BOTH DAMPENING DEMAND AND VACUUMING UP EXCESS PURCHASING POWER.

6. ONE AREA IN WHICH CONSUMER-ORIENTED INFLATION CAN BE SAID TO EXIST IN USSR IS COLLECTIVE FARM MARKETS, WHERE GENUINE SUPPLY-DEMAND AND MARKET FORCES DICTATE PRICE LEVELS. AVERAGE SOVIET CITIZEN SPENDS ABOUT 55-60 PERCENT OF HIS DISPOSABLE INCOME ON FOODSTUFFS, AND BUYS AN ESTIMATED 50 PERCENT OR MORE OF FRESH FRUITS AND VEGETABLES--AND

CONFIDENTIAL

PAGE 03 MOSCOW 15970 02 OF 02 211923Z

CONSIDERABLE AMOUNT OF MEAT AND DAIRY PRODUCTS--AT THESE MARKETS. GENERALLY, PRICES THERE APPEAR TO BE RISING FASTER THAN CURRENT AVERAGE ANNUAL 3.5 PERCENT GROWTH IN

INCOME. SOME SOVIET ECONMISTS ARGUE THAT ANNUAL INCREASES IN DISPOSABLE INCOME, PLUS INTEREST ON DEPOSITS IN SAVINGS BANKS, ARE MORE THAN ENOUGH TO COMBAT HIGHER PRICES AT FARM MARKETS. THIS IS DOUBTFUL.

7. IN SOVIET INDUSTRY, UPWARD WHOLESALE PRICE AJUSTMENTS ARE NOW COMMONPLACE AS A DELIBERATE POLICY--ACCORDING TO SOVIET ECONMOISTS--OF "NARROWING THE GAP" BETWEEN WHOLESALE AND RETAIL PRICES. FURTHER, INDIVIDUAL PRODUCTION UNITS HAVE CERTAIN CLOSELY LIMITED FREEDOM TO RAISE UNILTAERALLY (WITH PERMISSION OF PARENT INDUSTRIAL MINISTIRES) PRICES ON PRODUCTS RESULTING FROM INTRODUCTION OF NEW TECHNOLOGICAL PROCESSES AND/OR OTHER INNOVATIONS. RETAIL PRICES APPARENTLY REMAIN UNCHANGED, WITH DIFFERENCE ABSORBED BY CENTRAL STATE BUDGET.

8. ON FIRST GLANCE IT WOULD APPEAR THAT THIS "INFLATION" MAY, IN THEORY AT LEAST, ULTIMATELY AFFECT CONSUMERS, SINCE STATE BUDGET IS COMPRISED ALMOST ENTIRELY OF PLANNED PROFITS FROM INDUSTRY, TURNOVER TAX RECEIPTS (LEVIED ONLY IN CONSUMER SECTOR), AND PERSONAL INCOME TAX RECEIPTS. IN FACT, HOWEVER, THERE HAVE BEEN NO RECENT INDICATIONS OF INCREASES IN PERCENTAGES OF TURNOVER TAX APPLIED TO CONSUMER GOODS. THIS VARIES FROM ITEM TO ITEM. INSTEAD, GOVERNMENT IS OBTAINING VASTLY INCREASED RECEIPTS ANNUALLY FROM TURNOVER TAX SIMPLY THROUGH MAJOR INCRESSES IN SALE TO PRIVATE CITIZENS OF AUTOMOBILES. THIS IS THE COMMODITY ON WHICH THERE IS HIGHEST TURNOVER TAX IN THE USSR--APPROXIMATELY 300 PERCENT. STOESEL

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